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TAGS: DR ECON EFIN ENRG
SUBJECT: IMF TEAM REPORTS STRONG EFFORT BUT MISSED TARGETS
ON PERFORMANCE CRITERIA

¶1. (SBU) Summary: International Monetary Fund review team members commented May 5 that despite strong effort, the GODR has failed to meet the Fund Standby Agreement performance criteria on monetary, fiscal and debt levels. IMF representatives pointed to higher-than-expected first quarter inflation, increase in dollar-based energy costs, and the weaker-than-expected peso as the primary reasons for not meeting the targets. The team said that the GODR will need to present a credible plan to get back on track with the agreement in order for the Fund Board to consider waivers when the Dominican Republic is next on its agenda, in late June. End Summary.

¶2. (SBU) IMF review team leader Jose Fajgenbaum, team member Steven Phillips and resident representative Ousmene Mandeng briefed the Ambassador and Emboffs May 5 on the Fund's initial findings from the first formal review of the Dominican Republic since the Board approved the revised agreement in February. They reported that the GODR missed the performance criteria, but has shown a more focused effort since the Paris Club agreement in mid April.

First the Good News

¶3. (SBU) The Fund Representatives said that the GODR appears to have turned the corner on monetary policy and brought inflation under control. They reported that inflation for March was around 2 percent. (The Central Bank reported cumulative inflation for January and February exceeded 24 percent -- 10 points above projections.) They gave high marks for the Central Bank's recent handling of monetary policy and said that although the peso was trading lower against the dollar than the Agreement had assumed, it has remained stable. They also said that they had not detected a surge in election-related spending as many had feared.

Monetary Base Target Will need to Adjust

¶4. (SBU) Although the Central Bank made progress in reducing the monetary base, the representatives said it did not make sense to maintain the program levels for base money because of the high first quarter inflation. Nevertheless, the team said that the GODR would have to have a clear policy outline before the review team could take the issue to the IMF Board for a waiver. The GODR had reduced the monetary base by transferring bank reserves into Central Bank certificates of deposit, and at the same time increasing the vault cash holding requirement for banks to five percent of deposits.

¶5. (SBU) When asked about the impact of Baninter certificates on the monetary base, the team said that most of the certificates were being renewed as they came due. They reported that about RD nine billion ($200 million) of the original certificates were coming due soon, but expressed confidence that a sufficient amount would be rolled over to avoid much impact on the monetary base. (Note: RD nine billion represents about 13 percent of base money.)

Fiscal Target is Biggest Issue

¶6. (SBU) The review team members were most concerned about the fiscal targets, which they said are really the center of the Standby Agreement. They reported that the GODR would not meet the objectives on either the revenue or expenditure sides of the fiscal program. They explained again that this was partly the result of shocks, such as inflation, the weak peso, high debt-service costs and the increase in oil prices, but that the GODR had been slow in responding to those shocks. Moreover, excessive expenditures were also the result of misguided policies, such as propane and electricity

subsidies. They confirmed what a Central Bank source had recently told Emboff that the GODR had blown through 60 percent of its annual energy subsidy budget in the first quarter of the year. Revenue fell short of the program target as well, though they did not specify to what extent. The representatives also expressed concern that the GODR is delaying payment of bills to make the shortfall appear less serious.

¶7. (SBU) Unlike for the monetary side, the team said they saw no reason to adjust fiscal targets and said that the IMF would no longer accept vague promises. The GODR would have to take further measures -- for example, accelerated tax reform -- to adjust for the slippage. They expressed doubt that the GODR would take any action prior to the May 16 election and that it might be difficult to pass meaningful tax reform until after inauguration August 16. The Fund members acknowledged that there has been discussion of tax reform issues, but the GODR appeared reluctant to put forward a firm proposal during the campaign. However, the team suggested that the GODR would have to take concrete fiscal measures before the Fund would consider a waiver.

Too Much New Debt

¶8. (SBU) The IMF representatives said that the GODR also missed the RD800 million debt target by some RD300 million ($65 million). They acknowledged that a large portion of new loans have not yet been disbursed, but explained that the IMF considers approved loans as part of the debt total. The team left open the possibility that some of the loans could be reversed, but also criticized the GODR for not having an effective system to monitor loans. They said that President Mejia told Technical Secretary Despradel to overturn anything the President approved that did not comply with the IMF program. Despradel told the team that loans were a "procedural headache." The IMF representatives remarked to Emboffs that domestic debt, and electricity sector debt, particularly, was difficult to monitor due to lack of transparency. This creates problems for both the Fund and the World Bank.

Banking Reform

¶9. (SBU) A second IMF team is in the Dominican Republic reviewing progress on banking reforms. The Fund representatives reported that banking reform is moving forward, but there have been delays. They noted that adopting international standards for bank capitalization remains an issue and said that there is disagreement among the banks -- and between banks and the Superintendent of Banks -- on what form standards should take. The team members said that the IMF is providing technical assistance in this regard, but at this point some banks are having difficulty meeting even local standards.

Next Steps

¶10. (SBU) The GODR will need to present a detailed plan on how it will get back in step with the fiscal targets, and resolve monetary and debt issues before the Fund Board will consider waivers. The team said that the current fiscal program is weak in specifics and that the GODR has a credibility problem with the Fund. Nevertheless, they said the Board will likely be sympathetic if the GODR takes corrective actions. The next opportunity for the Board to consider the Dominican Republic's program is in late June. They noted that there will not be further disbursements from the IMF before the Board meets.

Comment

¶11. (SBU) The IMF representatives seemed cautiously upbeat in their assessment of the program, despite the missed targets. They gave the GODR a fair amount of credit for effort, and expressed a sympathetic view concerning the external shocks. Nevertheless, the next few months could be more difficult. If Mejia survives the first round of presidential elections on May 16, he will be focused on the battle for reelection in the second round June 30th. If he loses in the first round, he will have three months left to govern before transferring power to a new president. Either scenario will be a severe test of discipline for his administration. End comment.

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